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TAGS: EFIN ECON RS
SUBJECT: GOR ADVISOR ON DIFFICULTIES FIGHTING GROWING
INFLATION

REF: A. (07) MOSCOW 5373

¶B. (07) MOSCOW 5200

Classified By: Ambassador William J. Burns, Reasons 1.4 (b/d).

Summary
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¶1. (C) Economic Experts Group (EEG) Director Yevsey Gurvich told us February 5 that fighting growing inflation was a GOR priority but that the tools at the government's disposal were inadequate to the task. In particular, the GOR had few levers with which to temper growing demand. Gurvich speculated that the Central Bank (CBR) would consider ruble devaluation in an effort to boost the country's exports and correct Russia's "unbalanced" economic growth. He doubted the GOR would meet its 8.5-percent inflation target for 2008 and that the year-end result would be closer to 10 percent. End Summary.

Inflation: Not Gone, Not Forgotten
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¶2. (C) Gurvich said the GOR's concern with inflation prompted Premier Zubkov to announce the establishment of an anti-inflation working group during the January 24 Cabinet meeting. At the time, inflation in January threatened to exceed 2 percent, an indication that the late 2007 price controls campaign had done little to mitigate rising price levels (Reftel A). (The month-end figure was actually 2.3 percent according to official figures.)

¶3. (C) Gurvich said the working group, chaired by Deputy Prime Minister and Finance Minister Aleksey Kudrin, presented its initial plan of action during the January 31 Cabinet meeting. The main proposals discussed were monitoring state corporations' foreign debt and increasing banks' reserve requirements. Gurvich said that the measures under consideration were not equal to the task of controlling inflation.

Russia's Economy: Unbalanced, Overheating
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¶4. (C) Gurvich, whose think tank advises the Finance Ministry, observed that Russia's economic growth had become "unbalanced" in recent years. Imports had grown "too rapidly." He noted that the "looming current account deficit" implied by rising imports threatened to increase Russia's vulnerability to external factors, such as higher world food prices (Reftel B). Gurvich also suggested that

rising imports threatened the competitiveness of Russian industry at home and abroad. To that end, he said that during the January 31 Cabinet meeting the CBR floated the idea of devaluing the ruble to boost exports.

¶5. (C) According to Gurvich, Russia underwent a genuine financial liberation following the loosening of capital controls in mid-2006. He posited that capital flows had replaced oil prices in terms of economic importance, a change that the newly implemented non-oil budget would only reinforce. However, the transition to becoming a net recipient of foreign capital after years of experiencing net capital outflow had generated inflationary pressure that the existing mix of policy tools was not prepared to manage.

¶6. (C) Gurvich said growing capital inflows had helped ease personal and corporate access to credit, thereby increasing aggregate demand, which had also been stoked by increased government spending. Although fiscal policy has produced a series of surpluses, government spending had nevertheless been rising steadily as a percentage of GDP. The result of the increasing demand was an overheating economy.

¶7. (C) Gurvich reiterated that the measures Kudrin and CBR Chairman Ignatiyev proposed during the January 31 meeting were "not fundamental enough" to keep inflation in check. He conceded that, although inflation was a high priority for the GOR, restraining demand was very difficult politically. Gurvich said the GOR's 2008 inflation target of 8.5 percent was optimistic and that he expected the year-end figure to reach 10 percent.

Comment
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¶8. (C) The expectation that inflation for the year will exceed the GOR's target was not news. The surprising part was that the director of an influential think tank, widely regarded as a de facto department within the Finance Ministry, openly acknowledged that the GOR is ill-equipped to control inflation without also hampering economic growth.
BURNS